SUPREME COURT, U. S.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967.

No. 652

GEORGE M. BARD, RALPH A. BOGAN, JR., EDWARD O. BOSHELL, M. M. HARDIN, HERBERT F. KORHOLZ, J. PATRICK LANNAN, HOWARD J. LAUHOFF, A. D. MARTIN, HAROLD G. MASON, J. EARLE MAY, HUGH C. MICHELS, AKSEL NIELSEN, D. W. REEVES, R. C. SCHENK, FRANKLIN B. SCHMICK, HAROLD C. STUART, ALBERT W. THOMSON, ARTHUR M. WIRTZ and FRANCIS C. WOOLARD,

Petitioners,

vs.

WILLIAM DASHO, DASHO-ROGERS, INC., an Illinois corporation, and MAURICE H. SCHY,

Respondents.

BRIEF FOR RESPONDENTS IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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THE GUNTHORP-WARREN PRINTING COMPANY, CHICAGO

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PRELIMINARY STATEMENT.

The five questions presented by petitioners suggest a failure to understand the theory of Count I of the complaint, a theory readily comprehended by the Court of Appeals and by the court held to be actionable under section 17(a) of the Securities Act of 1933, section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 of the Commission (the "anti-fraud provisions of the securities laws"). A brief review of the facts will bring petitioners' failure into sharper focus.

THE FACTS.

Count I alleges a conspiracy between the directors of The Susquehanna Corporation ("Susquehanna") and Herbert Korholz, all of whom are parties defendant, to defraud Susquehanna by causing it to purchase indirectly from its directors (the "Lannan group") 435,000 shares of Susquehanna stock at a price of $6,525,000.00, a sum $1,740,000.00 greater than the fair market value of the shares. The scheme was to be accomplished in two related steps.

The first step was the sale of the 435,000 shares by the Lannan group to Korholz who acted on behalf of defendant, American Gypsum Co. ("Gypsum"), a corporation controlled by Korholz through his ownership of 56% of that corporation's stock. The Lannan group agreed to vest de facto control of Susquehanna in Korholz by seriatim resignations as Susquehanna directors, the remaining directors to fill such vacancies on the board, as they occurred, by the election thereto of Korholz and his nominees. The success of the conspiracy depended upon the reelection of the Lannan group as Susquehanna directors at the annual stockholders' meeting to be held April 19, 1965.

To perform their part of the bargain, the Lannan group in March and April 1965, made written and oral solicitations of proxies pledged to their reelection as Susquehanna directors. These proxy solicitations contained misrepresentations of fact all of which were pleaded with particularity. The Lannan group was successful in electing thirteen out of fifteen members to the board. Within a month four members of the Lannan group resigned as directors. The remaining directors then elected Korholz chairman of the board and three of his nominees, impleaded as defendants, filled the other vacancies.

With control of both Susquehanna and Gypsum vested in Korholz, the second step in the conspiracy—the sale to

Susquehanna of the Lannan group's 435,000 shares of Susquehanna—could be realized through the device of a merger of Gypsum into Susquehanna. By issuing its shares for the outstanding shares of Gypsum, Susquehanna would acquire all of Gypsum's assets, including the 435,000 shares of Susquehanna acquired from the Lannan group. For these 435,000 shares Susquehanna would be obliged to pay in new shares the equivalent of $6,525,000.00 which included the premium of $1,740,000.00 wrongfully received by the Lannan group.

In May 1965, a dissident group of Susquehanna stockholders ("the Kansas City group") threatened a stockholder's suit against the defendants attacking the Lannan group's sale of the 435,000 shares of Susquehanna. To silence the Kansas City group, and to keep in darkness the Lannan group-Korholz conspiracy, the defendants caused Susquehanna to exchange 140,000 shares of Vanadium Corp. of America ("Vanadium") for 222,107 shares of Susquehanna, plus $300,685.00 in cash. The basis on which this exchange of stock was effected undervalued the Vanadium shares by $700,000.00, the profit realized by the Kansas City group a few days later on the sale of the 140,000 shares of Vanadium to the Vanadium Corp. of America.

By virtue of his control over the boards of directors of both Susquehanna and Gypsum, Korholz secured the passage of resolutions by the directors of both corporations recommending the merger of Gypsum into Susquehanna. On October 22, 1965, before the matter was submitted to the stockholders of either corporation, respondents filed Count I of the complaint, seeking to recover for Susquehanna the premium of $1,740,000.00 received by the Lannan group on the sale of the 435,000 shares of Susquehanna stock, the $700,000.00 lost to Susquehanna on the Vanadium transaction and asking that the proposed Susquehanna-Gypsum merger be enjoined.

The facts are not in dispute. The Lannan group's sale of the 435,000 shares of Susquehanna, the misrepresentations in the March and April 1965 proxy statements and the sale of the Vanadium stock were all alleged to be defendants' overt acts in furtherance of the conspiracy. By their motions to dismiss for failure to state a claim, petitioners admitted the truth of these allegations.

QUESTIONS PRESENTED.

The first question presented by petitioners (Pet. p. 2) is not compatible with Rule 23(c) of this court in that it is not expressed in the terms and circumstances of the case. As stated it calls for an answer without regard to the facts alleged in Count I. Respondents would restate the question presented as follows:

> May a corporation, induced by fraud to issue its stock in exchange for the stock of another corporation pursuant to a statutory merger, be a seller or purchaser of securities within the ambit of the anti-fraud provisions of the securities laws?

The second question presented by petitioners (Pet. p. 2) ignores the thrust of Count I, that the injured party was Susquehanna, not plaintiffs in their capacities as stockholders of the corporation; that the cause of action belongs to Susquehanna and was asserted by plaintiffs derivatively on behalf of Susquehanna. The second part deals with the sufficiency of the statement of the claim and does not fall within the purview of Rule 19 of this court.

The third question presented by petitioners (Pet. p. 3) ignores the conspiratorial framework of Count I and treats each allegation as an isolated transaction unrelated to the other overt acts alleged to be a part of the conspiracy.

The fourth question presented (Pet. p. 3) deals with the sufficiency of the statement of the claim and does not fall within the purview of Rule 19 of this court.

The fifth question presented (Pet. p. 3) is not compatible with Rule 23(c) of this court in that it is not expressed in the terms and circumstances of the case in the following respects:

(a) Plaintiffs did not sue as shareholders of a constituent corporation in a consummated merger.

(b) The proxy soliciting material about which complaint is made in Count I was not filed with the Commission.

Respondents submit that of the five questions presented by petitioners, only the first, as modified herein, is in accord with Rule 23(c) of this court.

REASONS FOR DENYING THE WRIT.

In the case at bar the Court of Appeals decided that a constituent corporation in a statutory merger (as distinguished from a shareholder of such corporation) induced by fraud to exchange its stock for stock of the other constituent corporation, was a seller of securities entitled to the protection of the anti-fraud provisions of the securities laws. The rule in *Dasho* is narrower than the federal question petitioners ask this court to settle. In view of the unanimity among the federal courts which have passed upon the issue in *Dasho,* the federal law is settled. While *Dasho* decided the issue for the first time at the appellate level, the right of a constituent corporation in a statutory merger to the protection of the securities laws has been upheld in *H. L. Green Company, Inc.* v. *Childree,* 185 F. Supp. 95, 96 (S. D. N. Y. 1960) and in *Simon* v. *New Haven Board & Carton Company,* 250 F. Supp. 297, 298, 299 (D. Conn. 1966), the only other cases in which the issue has been before the courts.

Dasho, H. L. Green and *Simon* are structured on the broad base of *Hooper* v. *Mountain States Securities Cor-*

poration, 282 F. 2d 195, 203 (5 Cir. 1960); *Ruckle* v. *Roto American Corporation,* 339 F. 2d 24, 27 (2 Cir. 1964); *Kane* v. *Central American Mining & Oil, Inc.,* 235 F. Supp. 559, 564 (S. D. N. Y. 1964) and others, which hold that a corporation induced by fraud to issue its stock in exchange for inadequate consideration is a defrauded seller under the federal securities laws.

Petitioners would distinguish a statutory merger from all other transactions in which a corporation exchanges its shares for shares of another corporation. Remedial statutes, as are the securities laws, are not to be emasculated by putting form above substance.

That the complexities of corporate mergers afford fertile ground for fraud need not be demonstrated by argument, or example. If a statutory merger is to be exempted from the anti-fraud provisions of the securities laws, there should be a compelling reason. No such reason appears in the adjudicated cases and such exemption is inconsistent with the broad purposes of the legislation—to protect investors and to keep the instrumentalities of interstate commerce and security exchanges free of fraud in security transactions.

It is the position of the Commission today, as disclosed by its brief *amicus* in *Dasho,* that the issuance of stock by a corporation, in exchange for stock of another corporation pursuant to a statutory merger, is a sale and purchase of securities under the anti-fraud provisions of the securities laws.

Petitioners (Pet. pp. 12-14) say the "no sale" theory (now codified in Commission Rule 133 promulgated under the Securities Act of 1933) is in conflict with the decision in *National Supply Co.* v. *Leland Stanford, Jr. University,* 134 F. 2d 689 (9 Cir. 1943). This is not the case. *National Supply Co.* was decided on the ground of laches, not upon

any principle germane to the issue before this court. Furthermore, by its express terms the rule applies only to section 5 of the Securities Act of 1933 governing the registration of securities. It has no application to the Securities Exchange Act of 1934, or in fact, to the fraud provisions of the Securities Act of 1933. This was made clear by the Commission at the time it promulgated Rule 133, saying in Commission Release No. 3420, August 2, 1951:

> "The new rule is specifically limited by its terms to Section 5 of the Securities Act. Consequently, whether or not a sale is involved for any other purpose will depend upon the statutory context, and the question should in no sense be influenced by the rule. As a matter of statutory construction, the Commission does not deem the 'no-sale theory' which is described in the rule as being applicable for purposes of any of the anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934."

Petitioners argue (Pet. pp. 14, 15) that the Court of Appeals, in considering the Lannan group's sale to Korholz of 435,000 shares of Susquehanna as actionable, was at variance with the rule in *Birnbaum* v. *Newport Steel Corp.*, 193 F. 2d 461 (2 Cir. 1952), since neither Susquehanna nor plaintiffs were parties to the sale. There is, however, no variance because *Birnbaum* does not apply. Count I alleges a conspiracy to sell the 435,000 shares to Susquehanna. The sale of the shares to Korholz acting for Gypsum was alleged as the first overt act of the conspiracy to sell the shares to Susquehanna. Korholz and Gypsum were conduits only. Under the theory of Count I, Susquehanna was the intended purchaser. Until the merger with Gypsum was consummated, the sale to Susquehanna of the 435,000 shares was executory, but this is of no moment since the securities laws extend to executory as well as executed sales of securities. Sec. 2(3) Securities Act

of 1933; Sec. 3(a) (13) (14) Securities Exchange Act of 1934.

The related federal question referred to by petitioners (Pet. pp. 15, 16) disappears upon a reading of Count I. Count I, of course, "made no allegation of any fraudulent misrepresentation or omission in the Proxy Statement relating to the merger, as filed with the Commission under Section 14(a) of the Exchange Act and circulated to the stockholders of Susquehanna and Gypsum" because the proxy statement petitioners refer to was issued three weeks after Count I was filed. Count I complained of misrepresentations in the proxy statements issued in March and April 1965, and those misrepresentations were pleaded with particularity. Respondents would point out that at the time the March and April 1965 proxy statements were issued, Section 14(a) of the Securities Exchange Act of 1934, governing the solicitation of proxies, did not apply to corporations, such as Susquehanna, which traded their stocks over-the-counter. The misrepresentations in the March and April 1965 proxy statements were, therefore, actionable only under the anti-fraud provisions of the securities laws.

CONCLUSION.

For the foregoing reasons, the petition for writ of certiorari should be denied.

Respectfully submitted,

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